1996 Agricultural Legislation Cuts Link Between Income Support Payments and Farm Prices

The Federal Agriculture Improvement and Reform Act of 1996 replaces income support payments tied to farm prices with a series of seven annual fixed but declining production flexibility contract payments, totaling more than $35 billion during 1996-2002. Participating farm operators must continue to comply with conservation provisions related to highly erodible land and wetlands preservation to receive contract payments.

Under pressure to have new legislation in place before spring planting got underway in mid-April and the winter wheat harvest began, Congress passed the Federal Agriculture Improvement and Reform Act of 1996 in late March 1996. Agriculture Secretary Glickman, although "concerned about the dissolution of the safety net that protects farmers and rural America during lean times," recommended that the President sign the bill. The President, in turn, signed the bill into law on April 4 "with some reluctance," stating that his goal is to have "truly farmer-friendly" legislation.

Failure to enact new legislation would have meant that many commodity programs would revert to "permanent law" dating back to 1938 and 1949, not to the Food, Agriculture, Conservation, and Trade Act of 1990. Most farm legislation subsequent to the permanent law has been temporary amendments that expire every 4 or 5 years.

If farm policy had reverted to permanent law, loan rates based on an outmoded formula would have skyrocketed, and programs would have become increasingly chaotic. The result would have been tremendous expense to taxpayers and long-lasting disruption in the farm sector. Nevertheless, after considerable discussion in Congress about whether to repeal the permanent law, the new 7-year farm legislation largely suspends permanent law provisions. This ensures that farm programs will be debated when the 1996 law expires.

The 1996 legislation overhauls many farm programs and policies that have been in place since the 1930's. In a move toward a more market-based agriculture, the legislation frees farmers from most production restrictions, eliminates acreage reduction (set-aside) requirements, and ends mandatory crop insurance. However, an operator who does not buy crop insurance must waive rights to disaster payments, if such payments are authorized.

The legislation also ends deficiency payments based on the difference between market prices for wheat, feed grains, cotton, and rice and their target prices. Instead, title I of the 1996 legislation, entitled the Agricultural Market Transition Act, authorizes a fixed production flexibility contract payment that is not linked to prevailing market prices, and that declines over the 7 years of the contract regardless of market conditions. Any operator receiving such a contract payment is required to comply with conservation and wetland protection provisions of the legislation.

Although both the House and Senate discussed eliminating the peanut and sugar programs, instead the new legislation modifies the programs and scales back the level of support. Nonrecourse loan programs for other commodities remain in place with some modification. For example, the legislation increases the interest rate for Commodity Credit Corporation (CCC) loans 1 percentage point over the CCC's cost of borrowing from the Treasury.

The revised dairy program provides for a 4-year phase-out of Federal purchases of cheese, butter, and nonfat dry milk. It also makes available to processors a recourse loan program to be implemented for these milk products beginning in 2000. The dairy program provides for consolidation and reform of Federal milk marketing orders within 3 years, to not less than 10 nor more than 14 orders. Meanwhile, however, in accordance with provisions of the 1996 Act, the Secretary of Agriculture has granted authority to implement a Northeast Interstate Dairy Compact based upon a finding of compelling public interest. Congressional consent for the compact terminates when the new consolidated Federal marketing orders become effective.

The 1996 legislation has several provisions related to conservation programs, including reauthorizing the Conservation Reserve Program (CRP) and the Wetlands Reserve

Program. Legislation provides funds to help farmers pay for conservation and pollution control projects through the Environmental Quality Incentives Program (EQIP).

The 1996 Legislation Removes the Link Between Income Support Payments and Farm Prices

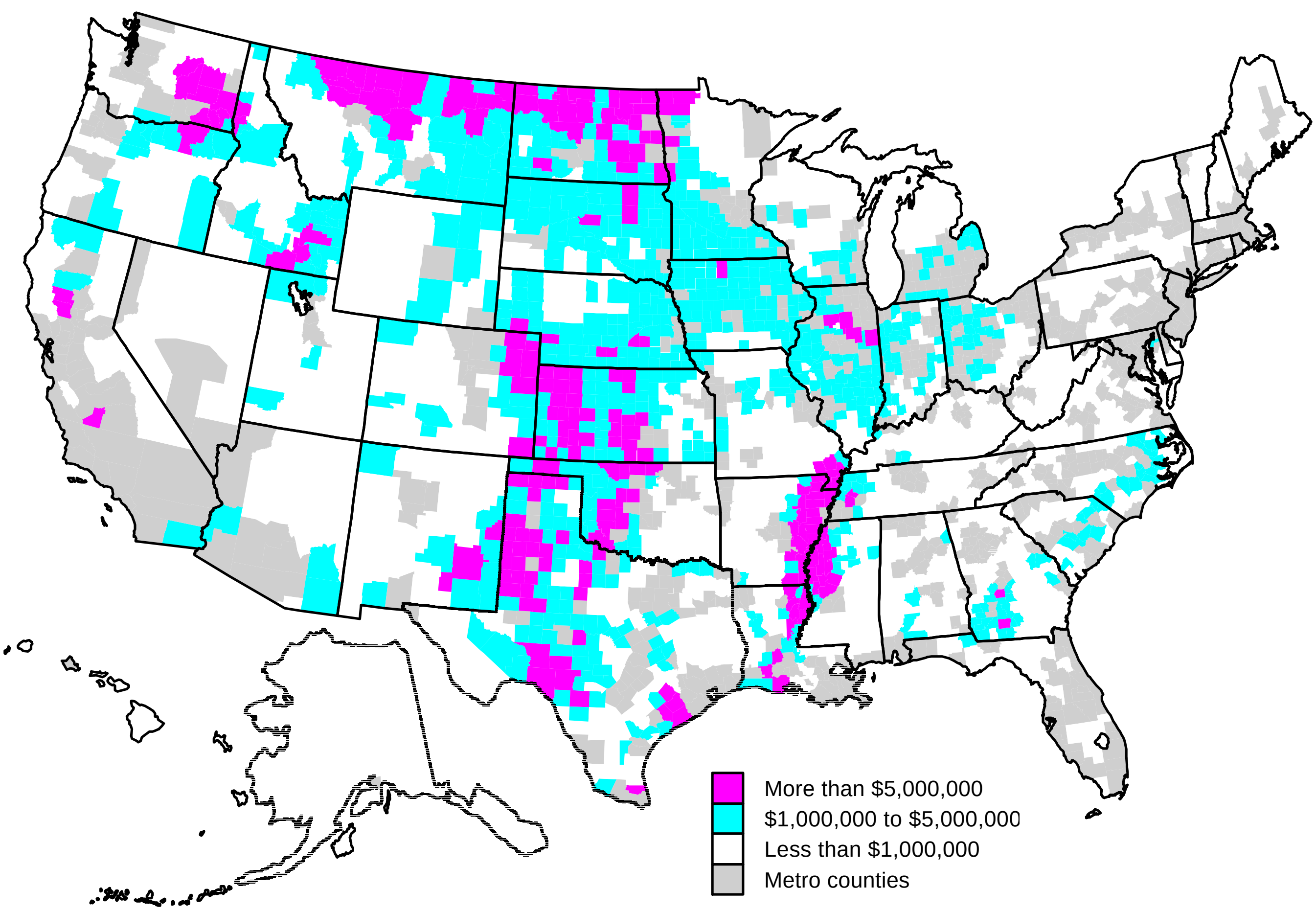
Direct payments to farmers through commodity programs (deficiency payments) were intended to provide some government control over production of selected farm products and to protect incomes of producers from wide swings in market prices. Eligibility sometimes required taking a portion of cropland out of production (set-aside), and the payment rate was based on the spread between target prices and market prices.

Direct payments to farmers for wheat, feed grains (corn, sorghum, barley, and oats), cotton, rice, and wool totaled nearly $5 billion in fiscal year 1994, with more than three-fourths going to nonmetro counties. These payments to farmers in nonmetro counties were concentrated in the Northern and Southern Plains, Corn Belt, and lower Mississippi Valley (fig. 1). Total direct payments per nonmetro county ranged from $0 to $10.6 million in fiscal year 1994, averaging $679,000.

Figure 1

Direct government payments to farmers in nonmetro counties, fiscal year 1994

Direct government payments for wheat, feed grains, cotton, rice, and wool provided more than $5 million to 213 nonmetro counties, primarily in the Northern and Southern Plains, and the lower Mississippi Valley



Note: The National Wool Act expired as of December 31, 1995.
Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

Direct payments under commodity programs added more than $70 per capita to non-metro county income, on average. Counties with the highest payments per capita were clustered primarily in the Northern and Southern Plains.

Under the new legislation, eligibility for the 7-year production flexibility contract payments requires that a farm operator have a planting history of a contract commodity for at least 1 of the previous 5 years, or have land that was enrolled in CRP with an associated planting history of a contract commodity. Thus, the market transition payments would, in most cases, go to those who had received deficiency or CRP payments in the recent past.

Nevertheless, the legislation does offer another avenue to obtain a contract. New entrants to farming or formerly nonparticipating operators may become program participants by purchasing or share-renting land that is already under a production flexibility contract. However, they will likely pay higher prices for land under contract. A purchaser may acquire rights to the remaining years of the contract payment by agreeing to comply with the conditions of the contract. If production flexibility contracts are not extended or replaced with another income support program when the current farm legislation expires, then land prices will likely reflect the effect of the loss of income from government payments.

Although the total national payout is fixed by law, the distribution of payments depends on how many producers participate and the number of contract acres. In addition to the currently eligible base, eligible cropland coming out of CRP could be added to the contract acreage at the beginning of each fiscal year.

The legislation establishes overall spending limits to the maximum extent practicable that decrease from $5.57 billion in fiscal year 1996 to $4.008 billion in fiscal year 2002. The allocation of contract payments remains set for the 7-year period for: wheat, 26.26 percent; corn, 46.22 percent; sorghum, 5.11 percent; barley, 2.16 percent; oats, 0.15 percent; upland cotton, 11.63 percent; and rice, 8.47 percent.

Because current commodity prices are high, deficiency payments under the old program would have been low. Production flexibility contract payments are not linked to market prices and are expected to be higher over the next 7 years than the amount projected for the old deficiency payments (fig. 2). Total outlays for production flexibility contract payments for fiscal year 1996 under the new legislation (over $5 billion) exceed outlays projected under the old program, and annual outlays will not fall below $5 billion until 2001.

By the August 1, 1996, deadline, over 97 percent of eligible acreage had been enrolled in 7-year Production Flexibility Contracts. The switch to the new program will offer a one-time boost to cash-flow for some farm operators. Advanced 1995-crop deficiency payments that have to be refunded because of overpayment will be added to funds available for contract payments. Then, 100 percent of the new contract payment for fiscal year 1996 will be paid by September 30, 1996, half of it within 30 days of signing a contract. For each of fiscal years 1997 through 2002, operators have the option of receiving 50 percent of the contract payment on December 15 or January 15 of the respective fiscal year, and the final payment no later than September 30.

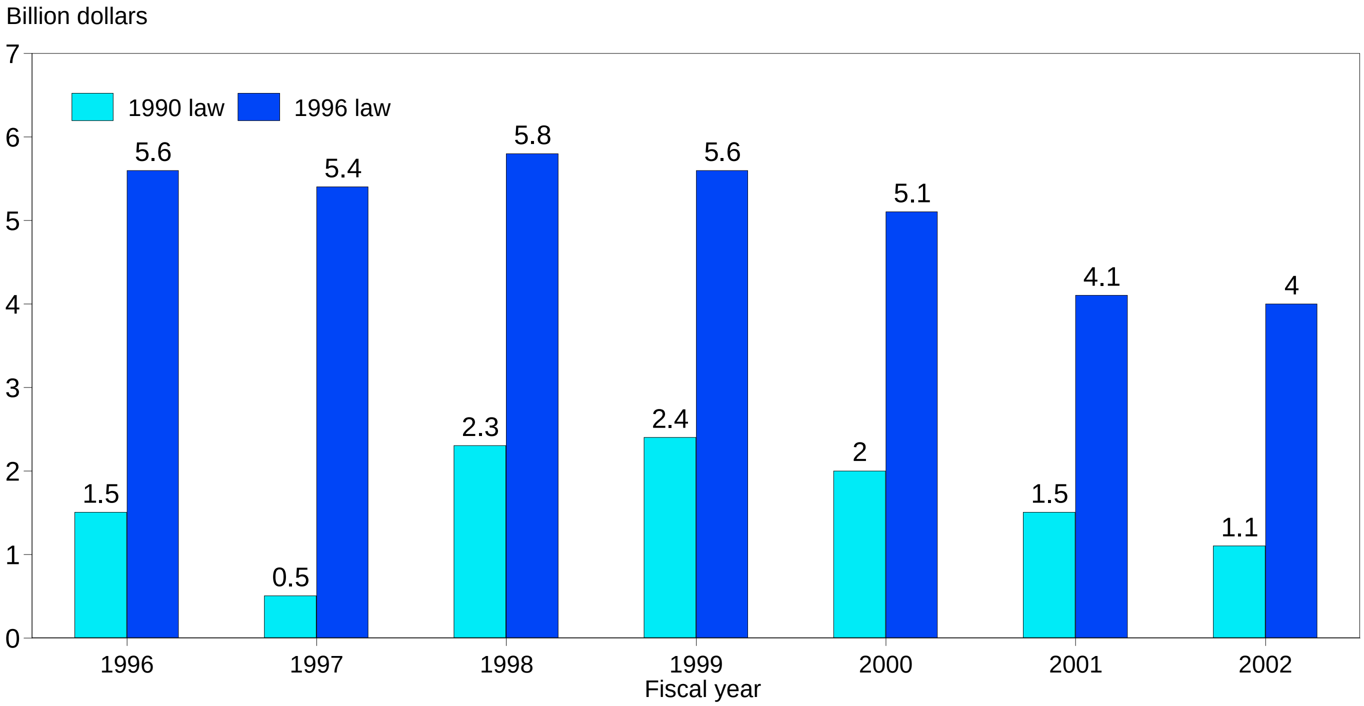
In 1994, 36 percent of all farms received direct government payments. Commercial-sized farms (those with sales of $50,000 or more) were more likely to participate in government programs than smaller farms, and these large farms received higher payments per farm, because payments were mainly based on acreage (fig. 3).

A large share of 1994 program payments went to producers of cash grains in rural areas of the Corn Belt and Northern Plains. In these regions, farms have higher debt/asset ratios and are more likely to have reached their debt-repayment capacity. Farms in the cotton-producing areas of the rural southwest also have high debt/asset ratios and farm income that is highly dependent on government payments. Operators of some of these farms may have difficulty adjusting as they shift to production based on anticipated market conditions with the new contract payments.

Figure 2

Projected direct farm payments

Under the 1996 legislation, the amount of Federal spending on direct farm payments is likely to be higher than the amount projected under the 1990 law



Source: "1996 Farm Act Impacts: An Early Assessment," Agricultural Outlook, Aug. 1996 pp. 22-25, C. Edwin Young and Paul C. Westcott, USDA/Economic Research Service.

Land in Expiring CRP Contracts May Be Added to Production Flexibility Contract Acreage

The Conservation Reserve Program (CRP) was authorized by the 1985 farm legislation as a voluntary long-term cropland retirement program with a soil conservation orientation. By the early 1990's, over 36 million acres of environmentally sensitive land were enrolled in the program, primarily under 10-year contracts. The 1996 legislation caps enrollment at about the current level, but allows the enrollment of new land as room is made available by the expiration or early termination of old contracts. Termination of contracts is not permitted for land enrolled after January 1, 1995, and deemed to be of high environmental value, or land that has been enrolled for less than 5 years.

Payments under the CRP totaled $1.7 billion in fiscal year 1994, with about 90 percent going to nonmetro counties (fig. 4). Income from CRP averaged $29 per capita in the nonmetro counties. In fiscal year 1994, 12 States, primarily in the Northern and Southern Plains and the Corn Belt, had more than 1 million acres enrolled in CRP. Most nonmetro counties where payments to operators totaled more than $1 million are located in those States.

Around 15 million acres of CRP-enrolled land under contracts scheduled to expire in 1996 were offered 1-year extensions. The number of acres that were extended is not yet known, but an additional 8.5 million acres is up for renewal in 1997 (fig. 5). Since base acres enrolled in CRP retain their planting history, some of this acreage would be eligible for production flexibility contracts. Overall, about two-thirds of CRP acres are eligible to be enrolled under production flexibility contracts.

Any increased economic activity in the farm sector could lead to growth in the nonfarm sector. If crop prices remain high and operators do not re-enroll farmland in CRP, acreage returned to production could provide some new jobs in agricultural production, and spending for agricultural inputs might increase. Additional employment in food and fiber processing, distribution, and marketing industries could result as more farm products move through domestic and world markets. However, little change is projected in land in production, and not all of the income and employment resulting from a return of CRP acreage to production would stay in rural areas. Nevertheless, some areas where farming is important could realize gains.

It is unknown whether these changes will translate into higher farm incomes beyond higher contract payments. If the additional supply cannot be absorbed in the marketplace and prices fall, farm incomes could drop and some of the potential benefits to rural communities would not materialize.

Effects of Changes in Farm Legislation Go Far Beyond Program Recipients

Farm programs provide a stable source of income to program participants and can benefit other agriculture-related businesses. Increased income generated in the farm sector contributes to expansion in the nonfarm sector as farm families buy additional goods and services in the local economy. Over time, government payments to farmers are capitalized into higher farmland values, improving the tax base for rural communities.

Not surprisingly, the 556 nonmetro farming-dependent counties are located in the same areas where direct government payments are concentrated. Direct government payments to individuals totaled more than $1 million in 73 percent of farm-dependent counties in fiscal year 1994. In addition, CRP payments to landowners totaled more than $1 million in 43 percent of nonmetro farm-dependent counties in fiscal year 1994. Dependence on income from farming and high levels of farm income from government payments make these counties especially sensitive to changes in farm programs. *[Judith E. Sommer, 202-501-8313, jsommer@econ.ag.gov, and Janet E. Perry, 202-219-0803, jperry @econ.ag.gov]*

Figure 3

Direct government payments, by sales class, 1994

Commercial-sized farms (sales $50,000 or more) got far more than their proportionate shares of government payments in 1994

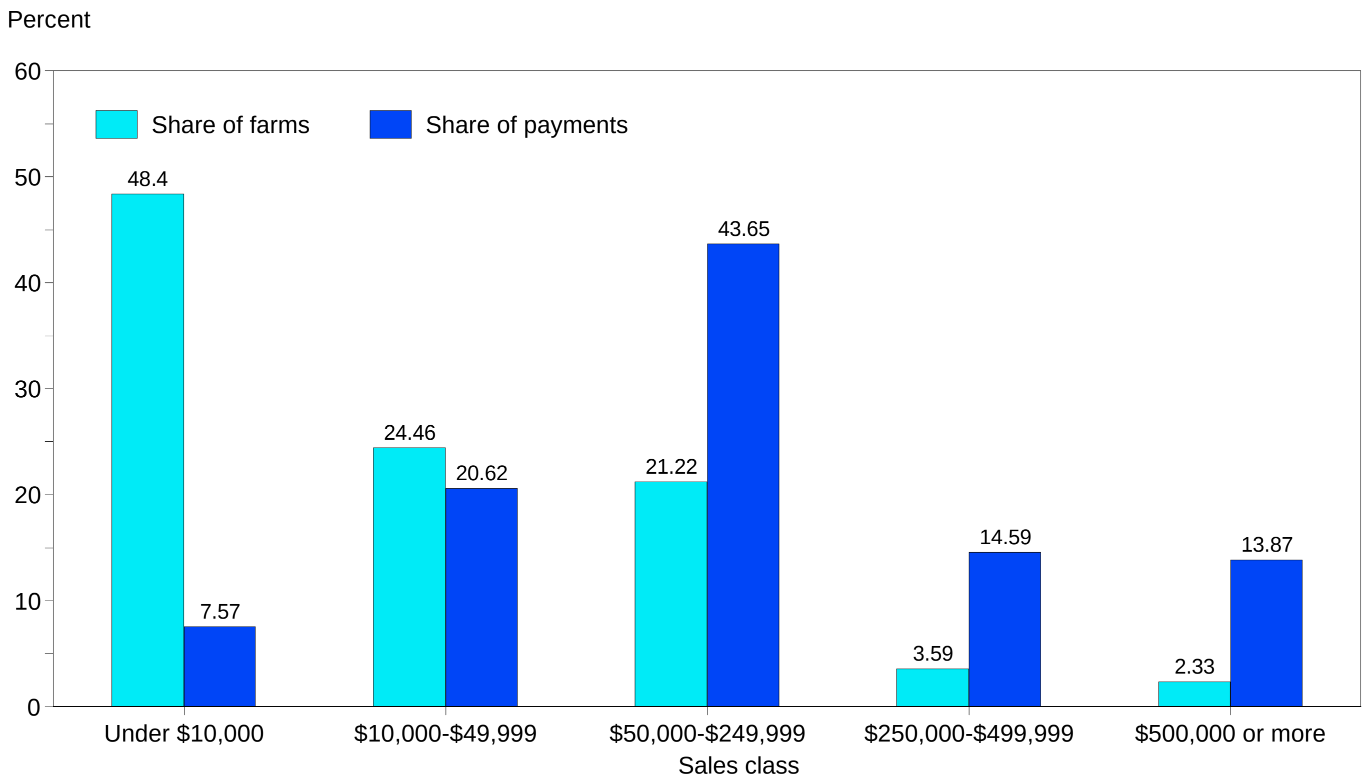
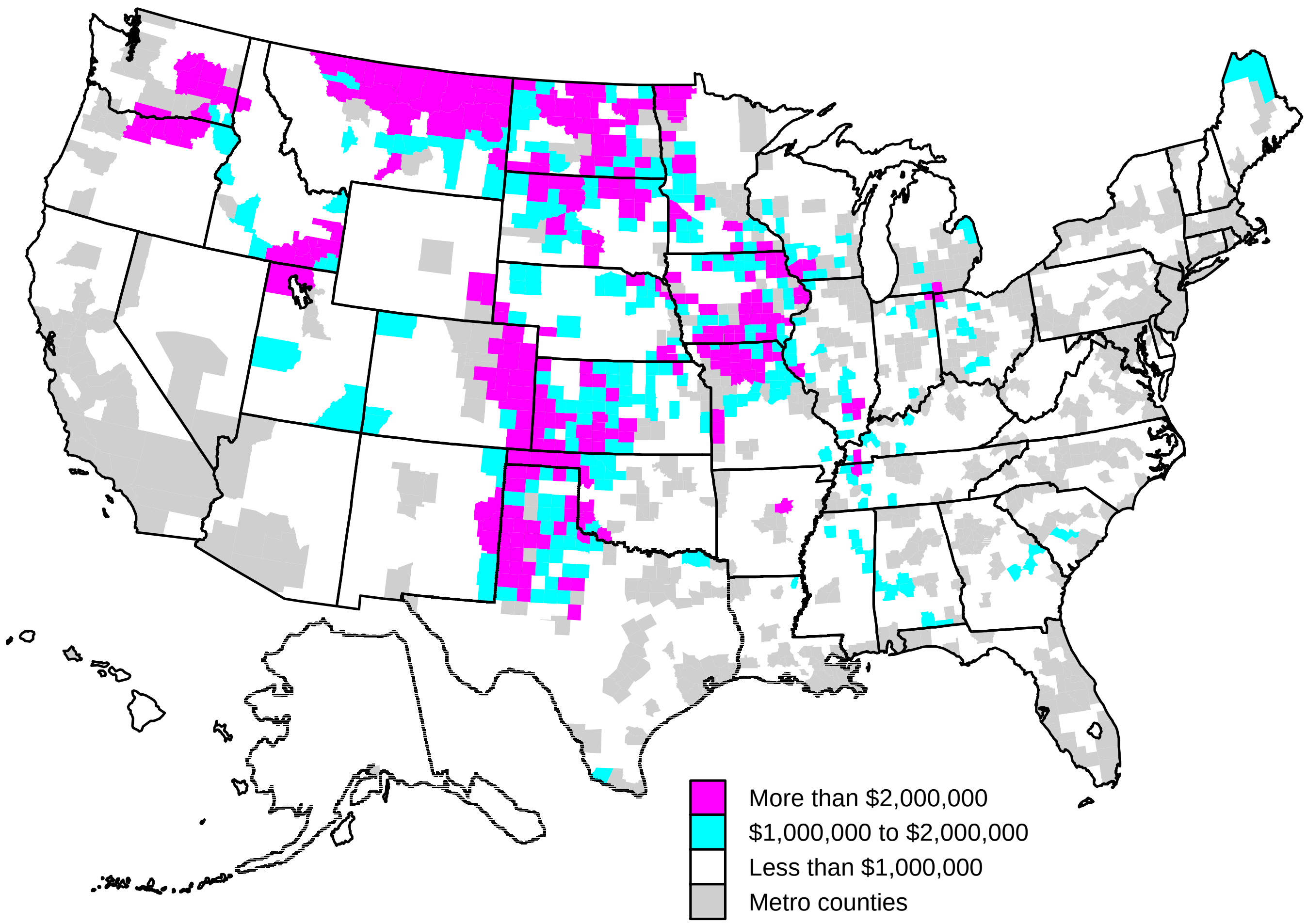


Figure 4

Conservation Reserve Program payments in nonmetro counties, fiscal year 1994

The 244 nonmetro counties that received more than $2 million from the CRP are clustered primarily in the Northern and Southern Plains, and the western Corn Belt

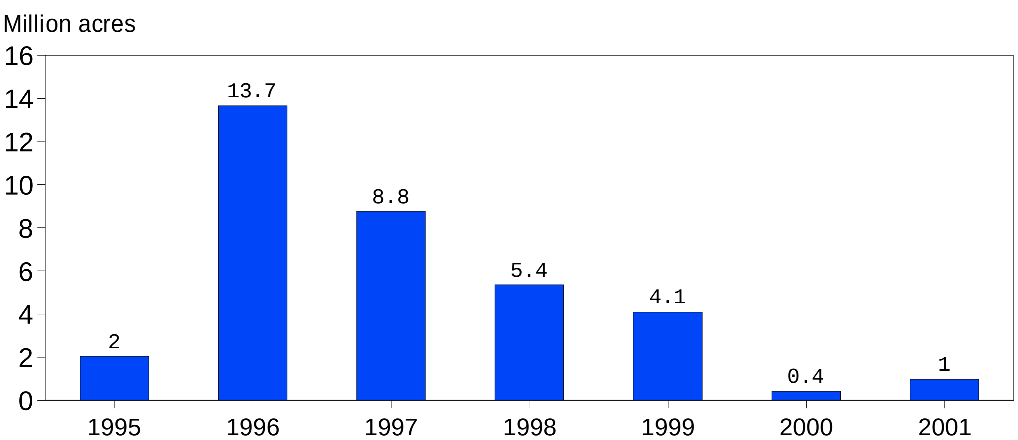


Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

Figure 5

Post-contract availability of Conservation Reserve Program land, 1994

More than two thirds of farmland put under CRP contracts during 1983-86 becomes available for cropping or other uses by late 1997



Source: USDA Conservation Reserve Program contract data.